Audit's® MARKET ANALYSIS OF SECURITIES OF REITS AND REAL ESTATE COMPANIES

Realty Stock Review

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MARKET COMMENT: A LOOK AT SOME EARLY NEW HIGHS BY REALTY STOCKS IN MARKET REBOUND

After dipping fairly sharply in the September quarter, the broad stock market has surged again in late October and early November and media are filled with news the Dow Jones Industrials surged to a new high (although the DJI has been buoyed by takeover activity in one component, General Foods).

A few hardy realty stocks have popped to new highs and it's worth taking a look since these early bloomers often foreshadow strong performers in the months ahead. (Realty stocks touching new highs dried up in the Sept. quarter when they underperformed the market.) These early birds aren't concentrated in any single real estate sector and finding a common thread is difficult. Here's a look at those making recent new 52-week highs:

Rouse Co, a premier shopping center developer; major arbitrageurs are reported buying aggressively;

Newhall Land & Farming, premier California community developer now operating as a tradable limited partnership;

Hotel Investors, a seasoned hotel operator where investor Leland Speed and his Eastover Corp. now own 8.8% and say they will mount a proxy fight for a board seat;

Federal Nat. Mtg. Assn. on hopes of much lower interest rates;

Lomas & Nettleton Financial, largest mortgage banker, on lower rates;

Landmark Land, California developer which owns Louisiana's largest S&L;

Radice Corp., fast growing Florida based land developer active in retirement housing and office building;

Southmark Corp., Dallas based major real estate trading and syndication company that is expanding rapidly into health care and financial services; and

Gould Investors Trust, Great Neck, N.Y. REIT that plans to convert into a tradable limited partnership.

Several threads intertwine:

--Takeover prospects, rumored or actual, are prominent in Rouse and Hotel Investors;

--Tradable limited partnerships with untaxed cash distributions are prominent in Newhall and Gould (see our review of UDC-Universal Sept. 27);

--Lower interest rates, big plays in FNMA, L&N Financial, and Landmark.

--Diversified, fast-growth companies with interests in healthcare, retirement housing, syndication and financial serivces are represented by Radice and Southmark.

Some idea of the strength behind

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NOW AVAILABLE: Our new brochure describing our money management services and two new separate accounts (TARESA Accounts - The Audit Real Estate Securities Accounts).

Your editor recently took part in a Wall Street Transcript panel on real estate developers and REITs. For a free copy, send a self-addressed stamped envelope (39¢).

KENNETH D. CAMPBELL, PRESIDENT/FAYE KREISMAN, STATISTICS/AUDIT INVESTMENTS, INC., 230 PARK AVE., N.Y. 10169

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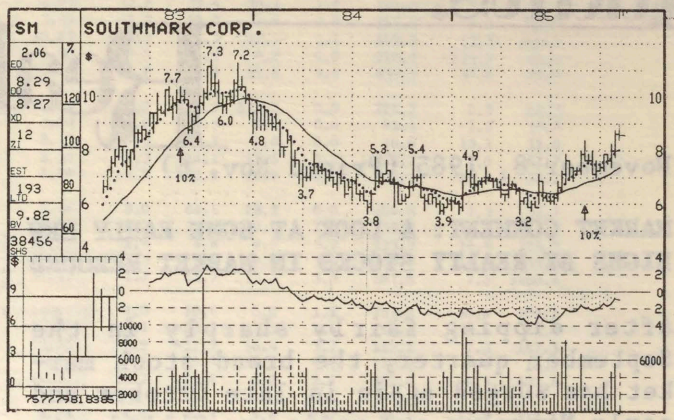
syndications emerged in a panel at the recent Natl. Assn. of REITs convention. Despite concern that proposed tax law changes would put real estate syndicators out of business, speakers said sales of real estate syndication interests have continued strong this year. Syndicators have sold about $10 of "one decision" limited partnership interests (i.e., buyers can't sell easily because there is no organized trading market such as exists for stocks) for each $1 raised by REITs in recent years. Now REIT and syndication markets are overlapping with emergence of "finite life" REITs and tradable limited partnerships this year. New REITs will raise about $3 bil. new capital this year, with about 40% being finite life REITs.

The flip side of the New High list is that companies exposed to office market overbuilding are prominent absentees (with exception of Radice). Long-term readers know we have been urging selectivity in stocks exposed to office markets, especially in the Sunbelt.

Some idea of the extent of the office overbuilding emerged at a NAREIT convention session when Prof. William C. Wheaton of Mass. Institute of Technology presented an "optimistic" forecast that national office vacancies would climb from about 16.5% now to about 21.3% by 1991. Prof. Wheaton argued that the 7%-10% growth in office employment in recent years is unsustainable because a) all job growth will slow gradually thru the year 2000, and b) manufacturing job growth has been sluggish, yet must grow dramatically to sustain office job growth. There is no realistic scenario to bring vacancy rates down short of a recession or dramatic slowing of office building starts, he contended.

While other speakers pointed to "windows of opportunity" in the present office market (the strong Northeast, for instance), the more prudent course for investors may well be to go to stocks in less saturated real estate sectors, hence the diversity among stocks making the New High list. Here are reviews of some stocks on the list plus several others of current interest.



RANKING REVIEWS: SOUTHMARK CORP. KEEPS GROWING INTO MAJOR REALTY CONGLOMERATE

Southmark Corp. ($8.38--NYSE) holds Rank in our annual review, based on earnings momentum. The stock chart above, courtesy R.W. Mansfield Co., bespeaks growing market recognition of SM as an asset play stock selling at 16% discount to historic cost book value.

EPS/Dividends - B: SM earned $1.74 primary ($1.71 diluted) in its June 1985 fiscal year, up 37% over a restated $1.25/sh. diluted. The year-ago number was restated downward by 24% (40¢) as result of S.E.C. pressure to use higher discount rates in valuing mortgages taken back in property sales. SM earned 45¢ sh. diluted in the Sept. qtr., up 80%. Since converting from a mortgage REIT, SM has been able to increase reported EPS and resume dividends, now at 24¢ annual rate.

SM total revenues rose 24% to $572.7 mil. in 1985, mainly on a 23% gain on net real estate sales to $324 mil. Real estate sales remain SM's major revenue source at 57% of revenues, and are 61% from direct sales to investors and consumers; 31% sales via syndications; and 8% condo conversions. But SM now has a diversified income stream including 16% interest on $548 mil. purchase money mortgages and contracts; 10% syndication, brokerage, property management fees; 8% rental and hospitality operations; 5% printing and direct mail; 4% equity in income of unconsolidated financial subsidiaries, mainly San Jacinto Savings Assn., Houston and Pacific Standard Life Co.

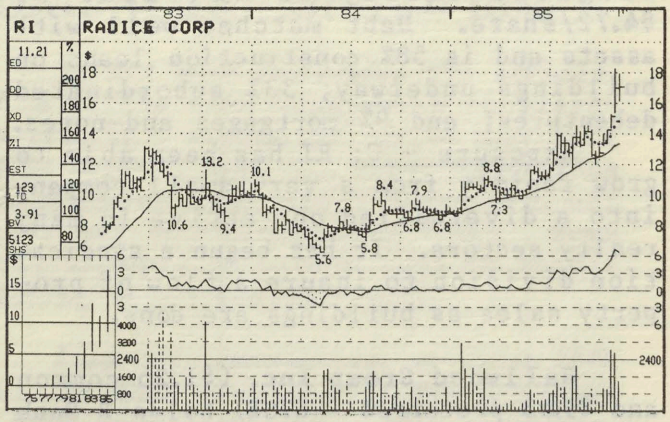
Operating profits of $232 mil. are derived 40% from direct property sales;

24% syndications; 11% resort/retirement; 4% property management operations; and 21% all other including financial subsidiaries. An aggressive acquisitor, SM has acquired $1 bil. of real estate over the past five years, including control of 17 real estate companies and partnerships and over 130 properties directly. Properties are not held for long-term investment but are managed aggressively to improve return and then sold to investors and, in the case of resort properties, to consumers. To facilitate some sales, SM is a major syndicator and in 1985 sold 24 privately offered syndications and has sponsored four public syndications with $167 mil. potential equity ($102 mil. sold) in the past two years. Recent acquisitions have focused upon operating real estate development companies, and SM thru various entities owns and/or manages over 10,700 nursing home beds; bought in August 1985, via San Jacinto, J.M. Peters Co., a southern Calif. homebuilder with $80 mil. revenues; and has agreed to buy Carlsberg Corp., publicly owned Calif. land developer for $48 mil. cash and preferred stock.

Financial subsidiaries include $2.4 bil. asset San Jacinto Savings, which generated $18 mil. income during 1985; $191 mil. asset Pacific Standard Life which earned $2.5 mil. in 1985. SM has agreed to buy the $750 mil.-asset Integon group of insurance companies from Ashland Oil for $157 mil. or about 49% of its $321 mil. equity, subject to regulatory approvals. SM has also bought 36% stake in Pratt Hotel Corp., owner of the Sands Hotel and Casino in Atlantic City, subject to regulatory qualification as a casino owner.

Financial Measures - C: Total debt of $846.1 mil. is 2.2 times net equity, to which we add $140 mil. liquidating value of preferred, for obligations of $986 mil. or 2.55 times net equity. Debt includes $353 mil. non-recourse mortgages on property owned or sold; $215 mil. subordinated debt; $222 mil. borrowings from financial institutions, and $55.8 mil. commercial paper and other notes. Equity of $387.4 mil. equals $10.06/share after a 10% stock dividend in August; we have not deducted intangible good will in arriving at this historic cost book value. About $204 mil. of debt matures during 1986, and SM has agreed to pay about $177 mil. cash to acquire Integon and Carlsberg. SM expects to fund liquidity needs with $141 mil. renewals of existing credits and $120 mil. additional credits being negotiated.

Exposure - B: SM has built a major realty trading company on the remains of a troubled mortgage REIT. Acquisitions have been financed with a combination of debt and securities based upon expected profit performance of acquirees. Real estate markets have favored this strategy for the past five years, but lower inflation ahead may require some corrections to strategy.



RANKING REVIEWS: GROWING RADICE CORP. AND EXPANDING HALLWOOD GROUP HOLD RANKS

Radice Corp. ($16.63--NYSE) holds C Rank because of higher leverage and absence of dividend.

EPS/Dividends - C: EPS rose 21% to $1.45/sh. in the June 1985 fiscal year; operating EPS have risen at 33.2% over the past five years. Like many smaller fast-track companies, RI has not paid a dividend. RI is a full-line property developer building both residential and commercial properties for sale. Revenues of $119.7 mil. in 1985 rose 30.5% and were derived 33% commercial property sales; 42% residential; 8.5% retirement housing; 11% land and investment properties; 5.5% developed lots and other.

Commercial property sales produce 51% gross margin and generated 56% of $36.6 mil. operating profit in 1985. Sales included a 107,000 sq. ft. Ft. Lauderdale office and six office/re-

search warehouse buildings with 200,000 sq. ft., also located in Ft. Lauderdale. This latter sale was made to a syndication sponsored by a national brokerage firm. RI has 6 buildings with 680,000 sq. ft. under construction and sale when leased. One 104,000 sq. ft. Pittsburgh office was recently leased to a major national tenant. Other operating profit sources are residential communities, 25% of the total; and retirement housing, 8.4%. RI is entering the lifecare field by building four RadiceCare projects, all in Florida, with 862 units, plus recreational and healthcare facilities.

Financial Measures - C: Face amount of debt of $106.2 mil. is 4.4 times net tangible equity of $24 mil. or $4.72/share. Debt matches well with assets and is 58% construction loans on buildings underway; 33% subordinated debentures; and 9% mortgages and notes.

Exposure - C: RI has been able to grow rapidly from a very small company into a diversified one active in many realty sectors. It has begun a syndication division to insure a flow of property sales as buildings are done.

Hallwood Group Inc. ($1.25 common and $9.63 preferred - NYSE) holds B Rank as a real estate trading company expanding rapidly into merchant banking.

EPS/Dividends - B: HWG earned 10¢ share in its July fiscal year, vs. 1.3¢ for a prior eight-months, when HWG was created by merger of two former REITs. HWG paid 8¢ dividend on the common, 56¢ on the preferred (which trades as a 7-unit common). HWG is planning a 1-for-14 reverse split to bring common prices to the $17.50 range, indicating an interest in seeking broader investment support. HWG's $21.4 mil. revenues in 1985 derived 28% interest on $44 mil. portfolio of mortgages and receivables, most from property sales; 8% from merchant banking, mainly restructing of troubled Saxon Oil Co. in 1985; 42% from rental income on a $50 mil. property portfolio; and 22% net gain on property sales. HWG hopes to do more troubled company restructurings and currently is involved in assisting Brock Hotels resolve its debt problems.

Financial Measures - A: HWG follows a policy of restricting leverage and $28.3 mil. debt is 0.37 times net shareholders' equity of $75.2 mil. or $1.17 per share fully converted. Book value will be $16.42/sh. after the reverse split. About $15 mil. debt is mortgages on properties, the rest loans secured by financial assets. Liquidity is high with $17.3 mil. cash (27¢ sh.).

Exposure - B: HWG has followed an unorthodox game plan in recycling funds from selling REIT-type assets into merchant banking. Goal is to produce earnings to use $22¢ taxloss carryforwards.

Mutual Real Estate Investment Trust ($10-OTC) is asking shareholders to end REIT qualification and reorganize as Intergroup Corporation. MREIT was organized in the 1960s to buy and manage integrated housing projects; it owns eight apartment projects with 1,322 dwelling units. Control passed to a West Coast investment group in July 1984, and the reorganized entity will continue property ownership while expanding into other business areas. No specific expansions have been revealed.

COMPARATIVE REALTY STOCK GROUP AVERAGE 11/06/85

GROUP NUMBER & NAME	DIV	NON-DIV	TOTAL	SHARE (000)	BOOK VALUE	ANN DIV	EARN ANN	LAST PRICE	-% CHNG FROM-- OCT 22	JAN 1	P/E RATIO	ANN YIELD	% PR TO BK	RETURN ON BK	MARKET VALUE
1 PROPERTY REITS	34	5	39	5094	11.17	1.23	1.12	15.19	0.6	7.0	13.5	8.1	135.9	10.1	3105.1
2 PROP & MTG COMB REITS	18	1	19	5189	13.16	1.63	1.98	16.39	1.9	-8.8	8.3	9.9	124.6	15.1	1705.6
3 MORTGAGE REITS	12	3	15	5833	14.92	1.72	2.58	15.21	3.3	-0.6	5.9	11.3	101.9	17.3	1327.5
4 PARTICIPATING MTG REITS	11	1	12	7687	12.78	1.18	1.12	13.36	2.0	-1.1	11.9	8.8	104.5	8.8	1318.1
5 MAJOR HOMEBUILDERS	8	2	10	14260	11.50	0.30	1.59	14.30	-0.7	-5.4	9.0	2.1	124.3	13.8	1746.7
6 OTHER BLDRS/DEVELOPERS	9	24	33	4879	6.82	0.08	0.22	9.16	2.6	23.1	40.9	0.9	134.3	3.3	1474.9
7 INCOME PROP BLDR/OWNR	13	8	21	6124	8.81	0.70	0.78	15.64	2.5	7.2	20.0	4.5	177.7	8.9	2614.0
8 MORTGAGE BANKER/FINANCE	7	6	13	10148	10.48	0.68	0.30	13.55	4.6	15.7	45.5	5.0	129.4	2.8	2738.8
9 DIVERSFIED RLTY&HOLDING	13	9	22	18482	13.39	0.31	1.10	19.04	2.6	24.2	17.3	1.6	142.2	8.2	11277.5
10 RLTY SVCS/SYNDICATOR	4	3	7	6780	6.41	0.09	0.62	9.52	-1.9	11.7	15.3	1.0	148.6	9.7	405.8
11 MANUFACTURED HOUSING	3	7	10	11747	5.38	0.12	0.18	7.50	1.0	-18.8	41.9	1.6	139.5	3.3	943.3
P PREFERRED STOCKS			3	2596	8.83	0.80	0.00	12.09	5.8	20.3	NC	6.6	136.8	NC	89.8
L LIQUIDATING COS			4	6900	10.55	5.17	14.76	7.69	0.0	-28.7	NC	NC	72.9	NC	136.3
OVERALL AVERAGE			208	8023	10.53	0.77	1.03	13.94	1.9	6.5	13.5	5.6	132.4	9.8	28883.4
DOW JONES INDUSTRIALS							102.26	1403.44	2.9	15.8	13.7	4.5			
STANDARD & POOR'S 500							15.81	192.76	2.5	15.3	12.2	4.1			
DOW JONES UTILITIES							18.74	160.70	2.9	7.5	8.6	8.8			

NOTE: LIQUIDATING COMPANIES AND PREFERRED STOCKS INCLUDED ONLY IN COMPANY AND MARKET VALUE AGGREGATES; NOT INCLUDED IN OVERALL AVERAGES.